

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Unit Name South Haven Community Hospital Authority	County Van Buren
Fiscal Year End June 30, 2006	Opinion Date August 9, 2006	Date Audit Report Submitted to State 10/30/06	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

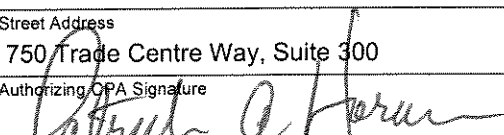


Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☐ ☒ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☒ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☒ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Plante & Moran, PLLC		Telephone Number 269-567-4500	
Street Address 750 Trade Centre Way, Suite 300		City Portage	State MI
Authorizing CPA Signature 		Printed Name PATRICK A. MORAN	Zip 49024
		License Number 1101010473	

South Haven Community Hospital Authority

Financial Report
June 30, 2006

South Haven Community Hospital Authority

Contents

Report Letter	I
Financial Statements	
Balance Sheet	2
Statement of Revenues, Expenses, and Changes in Net Assets	3
Statement of Cash Flows	4-5
Notes to Financial Statements	6-18



Plante & Moran, PLLC

Suite 300
750 Trade Centre Way
Portage, MI 49002
Tel: 269.567.4500
Fax: 269.567.4501
plantemoran.com

Independent Auditor's Report

To the Board of Directors
South Haven Community Hospital Authority

We have audited the accompanying balance sheet of South Haven Community Hospital Authority (the "Hospital") as of June 30, 2006 and 2005 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of South Haven Community Hospital Authority at June 30, 2006 and 2005 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements do not present the management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be part of, the basic financial statements.

Plante & Moran, PLLC

August 9, 2006

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South Haven Community Hospital Authority

Balance Sheet

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	\$ 538,592	\$ 1,408,495
Accounts receivable (Note 3)	4,658,317	3,701,261
Other current assets	412,244	617,923
Total current assets	5,609,153	5,727,679
Assets Limited as to Use (Note 2)	10,214,288	10,105,230
Property and Equipment (Note 4)	15,044,079	15,918,280
Total assets	\$ 30,867,520	\$ 31,751,189
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 7)	\$ 473,333	\$ 473,333
Accounts payable	912,091	1,262,106
Estimated third-party payor settlements (Note 5)	1,685,004	1,841,353
Retainage payable	-	113,055
Accrued liabilities and other (Note 6)	1,321,294	1,305,228
Total current liabilities	4,391,722	4,995,075
Long-term Debt (Note 7)	5,680,001	6,153,334
Total liabilities	10,071,723	11,148,409
Net Assets		
Invested in capital assets - Net of related debt	8,890,745	9,291,613
Donor restricted for specific operating activities	22,109	22,109
Unrestricted	11,882,943	11,289,058
Total net assets	20,795,797	20,602,780
Total liabilities and net assets	\$ 30,867,520	\$ 31,751,189

South Haven Community Hospital Authority

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	June 30, 2006	June 30, 2005
Operating Revenues		
Net patient service revenue	\$ 27,586,473	\$ 24,660,687
Other	111,555	101,813
Total operating revenues	27,698,028	24,762,500
Operating Expenses		
Salaries and wages	11,392,451	10,939,347
Employee benefits and payroll taxes	3,397,861	2,517,294
Operating supplies and expenses	3,647,672	3,347,553
Professional services and consultant fees	1,937,897	1,915,322
Purchased services	2,425,692	2,414,406
Insurance	852,290	527,706
Utilities and maintenance	1,249,026	1,084,142
Other	524,522	417,753
Depreciation	2,262,398	1,989,259
Total operating expenses	27,689,809	25,152,782
Operating Income (Loss)	8,219	(390,282)
Nonoperating Income (Expense) (Note 10)		
Investment income	52,554	20,090
Gain (loss) on sale of property	10,754	(20,598)
Contributions	7,000	-
Interest earnings on restricted assets	419,935	451,264
Property taxes	349,860	365,107
Change in unrealized investment gain (loss)	(306,850)	(81,998)
Interest expense	(278,087)	(286,402)
Rent income	(75,430)	(59,001)
Other expense	5,062	53,269
Total nonoperating income	184,798	441,731
Increase in Net Assets	193,017	51,449
Net Assets - Beginning of the year	20,602,780	20,551,332
Net Assets - End of the year	\$ 20,795,797	\$ 20,602,781

South Haven Community Hospital Authority

Statement of Cash Flows

	Year Ended	
	June 30, 2006	June 30, 2005
Cash Flows from Operating and Nonoperating Activities		
Cash received from patients and third-party payors	\$ 26,473,068	\$ 23,260,880
Cash payments to suppliers for services and goods	(25,668,736)	(23,243,426)
Other receipts from operations	111,555	101,813
Net cash provided by operating activities	915,887	119,267
Cash Flows from Noncapital Financing Activities		
Property taxes	349,860	365,107
Donations and other receipts	12,062	43,268
Net cash provided by noncapital financing activities	361,922	408,375
Cash Flows from Investing Activities		
Increase (decrease) in assets limited as to use	(415,908)	1,015,193
Income received from investments	472,489	471,354
Rental receipts - Net of expenses paid	(8,194)	8,239
Net cash provided by investing activities	48,387	1,494,786
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(1,481,425)	(3,485,237)
Proceeds from sale of capital assets	36,746	35,398
Interest paid on long-term debt	(278,087)	(286,402)
Principal payments on notes payable	(473,333)	(473,333)
Net cash used in capital and related financing activities	(2,196,099)	(4,209,574)
Net Decrease in Cash and Cash Equivalents	(869,903)	(2,187,146)
Cash and Cash Equivalents - Beginning of year	1,408,495	3,595,641
Cash and Cash Equivalents - End of year	\$ 538,592	\$ 1,408,495

South Haven Community Hospital Authority

Statement of Cash Flows (Continued)

A reconciliation of operating income (loss) to net cash from operating activities is as follows:

	Year Ended	
	June 30, 2006	June 30, 2005
Cash Flows from Operating Activities		
Operating income (loss)	\$ 8,219	\$ (390,282)
Adjustments to reconcile operating income (loss) to net cash from operating activities:		
Depreciation	2,262,398	1,989,259
Provision for bad debts	4,923,159	4,711,831
Change in assets and liabilities		
Increase in patient accounts receivable	(5,880,215)	(6,007,308)
(Increase) decrease in other current assets	205,679	(129,278)
Increase (decrease) in accounts payable	(463,070)	333,707
Increase (decrease) in other accrued expenses	16,066	(284,332)
Increase (decrease) in third-party settlement payables	(156,349)	(104,330)
Net cash provided by operating activities	<u>\$ 915,887</u>	<u>\$ 119,267</u>

Significant noncash investing, capital, and financing activities for 2006 and 2005 are as follows:

- Medical office building rent, net includes an allocation of depreciation expense, totaled \$67,236 and \$67,240 in 2006 and 2005, respectively.
- The net decrease in fair value of investments for years ended June 30, 2006 and 2005, totaled \$306,850 and \$81,998, respectively.
- A gain (loss) on disposal of assets for the years ended June 30, 2006 and 2005, totaled \$10,754 and (\$20,598), respectively.
- Included in capital assets at June 30, 2005 is \$113,055 of construction in progress financed by accounts payable.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 1 - Nature of Business and Significant Accounting Policies

Reporting Entity - South Haven Community Hospital Authority (the "Hospital") is a short-term, acute-care facility offering inpatient and outpatient health care services primarily to citizens of South Haven, Michigan and several adjacent townships. The Hospital is organized pursuant to Public Act 47 of Public Act 5 of 1945. A significant portion of the Hospital's receivables relates to contractual arrangements with Medicare, Medicaid, and Blue Cross/Blue Shield programs.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation - The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. No component units are required to be reported in the Hospital's financial statements.

Enterprise Fund Accounting - The Hospital uses Enterprise Fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

Assets Limited as to Use - Assets limited as to use include assets designated by the board of trustees for future capital improvements, over which the board retains control, and may, at its discretion, subsequently use for other purposes.

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in nonoperating income.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note I - Nature of Business and Significant Accounting Policies (Continued)

Property and Equipment - Property and equipment amounts are recorded at cost. Donations of property and equipment are recorded at fair market value at the date of donation. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Costs of maintenance and repairs are charged to expense when incurred.

Compensated Absences - Compensated absences are charged to operations when they are earned. Unused benefits are recorded in accrued liabilities on the financial statements.

Classification of Net Assets - Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by those creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. Unrestricted net assets are remaining net assets that do not meet the definition of the other two categories of net assets. Included in the unrestricted net assets reported at June 30, 2006 and 2005 is \$10,189,288 and \$10,080,230, respectively, which has been designated by the Hospital's board of trustees for future capital acquisitions. Designated funds remain under the control of the board of trustees, which may, at its discretion, later use the funds for other purposes.

Net Patient Service Revenue - Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined (see Note 5). In addition to contractual provisions, net patient service revenue is presented net of provision for bad debts of \$3,900,000 and \$4,700,000 in 2006 and 2005, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Operating Revenues and Expenses - The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Hospital's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Nonoperating activities, including investment income and contributions received for purposes other than capital asset acquisition, and interest expense, are reported as nonoperating revenue and expense.

Tax Levy - Property taxes are both measurable and available for use to finance operations are recorded as nonoperating revenue when earned. Property taxes are levied on December 1 and are intended to finance the Hospital's activities of the same fiscal year. Amounts levied are based on assessed property values as of the preceding July 1.

Reclassifications - Certain amounts in the Hospital's 2005 financial statements have been reclassified to conform with the presentation in the Hospital 2006 financial statements.

Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended), authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investments in United States government and agency obligations, commercial paper backed by a bank letter of credit, and certificates of deposit (CD), but not the remainder of state statutory authority as listed above. The Hospital's deposits and investment policies are in accordance with statutory authority, except for certain investments in corporate bonds.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

The Hospital's cash and investments are subject to several types of risk, which are examined in more detail below for the year ended June 30, 2006:

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At year end, the Authority had \$2,062,543 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Authority evaluates each financial institution it deposits funds with and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. All of the Hospital's investment securities were insured and registered, with securities held by the counterpart in the Hospital's name. The Hospital does have investments held by an investment manager that is not considered a financial institution. They are disclosed below:

Type of investment	Carrying value	How held
Edward Jones	\$ 115,142	Counterparty

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities. At year end, the maturities of investments are as follows:

Investment	Fair Value	Maturity Date
Corporate bonds	\$ 100,753	3/1/07
Corporate bonds	102,164	8/15/08
Corporate bonds	95,008	1/15/10
Corporate bonds	100,628	1/15/07
Corporate bonds	100,162	8/28/09
Corporate bonds	101,077	5/1/07
Corporate bonds	97,970	5/15/07
Corporate bonds	98,981	11/1/06
Corporate bonds	97,474	1/15/08
Investment pool	836,898	5/20/35
Investment pool	193,803	9/15/10
Investment pool	189,284	9/1/11
Investment pool	100,250	5/15/10

Credit Risk

The Hospital holds approximately \$875,000 worth of corporate stock as of June 30, 2006. These stocks were gifted to the Hospital in previous years. Inherently, stock has significant market risk and can fluctuate dramatically from day to day. The Hospital's investment policy does not speak to stock investments.

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital's policy states all investment grade securities shall be limited to bonds rated AAA, AA, or A by Standard & Poors or Moody's rating systems. As of June 30, 2006, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating organization
Corporate bonds	\$ 201,381	A1	Moody's
Corporate bonds	101,077	Aa1	Moody's
Corporate bonds	100,162	A2	Moody's
Corporate bonds	98,981	Aa2	Moody's
Corporate bonds	97,474	A3	Moody's
Corporate bonds	295,142	Aa3	Moody's

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

Concentration of Credit Risk

The Hospital's policy has placed a limit on the amount of investments that can be held at any one financial institution. The limit per local institution is 50 percent. The Hospital's investment policy includes certificates of deposit and money market funds as investments. The Hospital is in compliance with its investment policy as it relates to investments per institution. However, for GASB 40 purposes, certificates of deposit and money market funds are not considered investments. Removing these funds from the calculation results in the Hospital having investments in one institution of approximately 53 percent as of June 30, 2006. The Hospital's policy also states that at least 50 percent of the invested funds must be maintained in fixed income investments. The Hospital does have over 50 percent of their invested funds in fixed income investments at year end.

For comparative purposes, the following is presented for the year ended June 30, 2005:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At June 30, 2005, the Hospital had \$2,248,540 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. All the Hospital's investment securities were insured and registered, with securities held by the counterparty in the Hospital's name. The Hospital does have investments held by an investment manager that is not considered a financial institution. They are disclosed below:

Type of Investment	Carrying Value	How Held
Edward Jones	\$ 101,071	Counterparty

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities. At June 30, 2005, the maturities of investments are as follows:

Investment	Fair Value	Maturity Date
Corporate bonds	\$ 1,023,241	2.3 years
Investment pool	200,591	4.4 years
Investment pool	198,498	5.9 years
Investment pool	102,424	4.2 years
Investment pool	881,195	8.5 years

Credit Risk - The Hospital holds approximately \$870,000 worth of corporate stock as of June 30, 2005. These stocks were sifted to the Hospital in previous years. Inherently, stock has significant market risk and can fluctuate dramatically from day to day. The Hospital's investment policy does not speak to corporate stock investments.

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital's policy states all investment grade securities shall be limited to bonds rated AAA, AA, or A by Standard & Poors or Moody's rating systems. As of June 30, 2005, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Corporate bonds	\$ 505,625	A+	Standard & Poors
Corporate bonds	313,869	A	Standard & Poors
Corporate bonds	203,747	AA-	Standard & Poors

Concentration of Credit Risk - The Hospital's policy has placed a limit on the amount of investments that can be held at any one financial institution. The limit per local institution is 50 percent. The Hospital's policy also states that at least 50 percent of the invested funds must be maintained in fixed income investments.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2006	2005
Patient accounts receivable	\$ 16,458,317	\$ 14,501,261
Less:		
Allowance of uncollectible accounts	(4,900,000)	(4,500,000)
Allowance for contractual adjustments	(6,900,000)	(6,300,000)
Net patient accounts receivable	<u>\$ 4,658,317</u>	<u>\$ 3,701,261</u>

The Hospital is located in South Haven, Michigan. The Hospital provides services without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors is as follows:

	Percentage	
	2006	2005
Medicare	21	23
Blue Cross/Blue Shield of Michigan	14	12
Medicaid	17	24
Commercial insurance and HMOs	16	8
Self-pay	32	33
Total	<u>100</u>	<u>100</u>

Note 4 - Capital Assets

Cost of capital assets and related depreciable lives as of June 30, 2006 are summarized below:

	2005	Additions	Transfers	Retirements	2006	Depreciable Life - Years
Land and land improvements	\$ 882,447	\$ 35,748	\$ -	\$ -	\$ 918,195	3-25
Building and improvements	19,274,320	133,008	1,166,003	-	20,573,331	10-40
Furniture, fixtures, and equipment	11,148,530	862,731	-	(286,806)	11,724,455	6-20
Construction in progress	845,036	449,938	(1,166,003)	-	128,971	
Total	32,150,333	1,481,425	-	(286,806)	33,344,952	
Less accumulated depreciation:						
Land and land improvements	293,559	20,930	-	-	314,489	
Building and improvements	9,441,067	834,114	-	-	10,275,181	
Furniture, fixtures, and equipment	6,497,427	1,477,432	-	(263,656)	7,711,203	
Total depreciation	16,232,053	2,332,476	-	(263,656)	18,300,873	
Net carrying amount	<u>\$15,918,280</u>	<u>\$ (851,051)</u>	<u>\$ -</u>	<u>\$ (23,150)</u>	<u>\$15,044,079</u>	

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 4 - Capital Assets (Continued)

Cost of capital assets and related depreciable lives as of June 30, 2005 are summarized below:

	2004	Additions	Transfers	Retirements	2005	Depreciable Life - Years
Land and land improvements	\$ 882,447	\$ -	\$ -	\$ -	\$ 882,447	3-25
Building and improvements	15,395,228	348,523	3,535,012	(4,443)	19,274,320	10-40
Furniture, fixtures, and equipment	9,902,692	1,350,435	1,178,166	(1,282,763)	11,148,530	6-20
Construction in progress	4,121,276	1,436,938	(4,713,178)	-	845,036	
Total	30,301,643	3,135,896	-	(1,287,206)	32,150,333	
Less accumulated depreciation:						
Land and land improvements	275,516	18,043	-	-	293,559	
Building and improvements	8,747,497	698,013	-	(4,443)	9,441,067	
Furniture, fixtures, and equipment	6,379,251	1,340,443	-	(1,222,267)	6,497,427	
Total depreciation	15,402,264	2,056,499	-	(1,226,710)	16,232,053	
Net carrying amount	\$14,899,379	\$ 1,079,397	\$ -	\$ (60,496)	\$15,918,280	

Total depreciation expense for the years ended June 30, 2006 and 2005 was \$2,332,476 and \$2,056,499, respectively. Of those amounts, \$2,262,398 and \$1,989,259 was included in operations and \$70,078 and \$67,240, respectively, in nonoperating expenses related to the medical office building.

Note 5 - Estimated Third-party Payor Liability

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Approximately 67 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs. Subsidiaries of the Hospital have agreements with third-party payors that provide for reimbursement at amounts different from established rates. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient, acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient and homecare services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Rural health clinic services are paid based upon a limited-cost reimbursement methodology. All other outpatient and physician services are reimbursed on an established fee-for-service methodology.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 5 - Estimated Third-party Payor Liability (Continued)

- **Blue Cross/Blue Shield of Michigan** - Under an agreement with Blue Cross/Blue Shield of Michigan, the Hospital is paid based on a cost-plus-reimbursement methodology.

Included in this liability is approximately \$800,000 for potential credit balances due patients and third-party payors. Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs, which are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying financial statements.

Note 6 - Accrued Liabilities

The details of accrued liabilities at June 30, 2006 and 2005 are as follows:

	2006	2005
Payroll and related items	\$ 266,467	\$ 407,734
Compensated absences	503,866	457,986
Interest	45,090	46,791
Professional and other liability claims (Note 9)	250,000	150,000
Self-insurance liability for medical claims (Note 9)	149,000	89,000
Other	106,871	153,717
Total accrued liabilities	<u>\$ 1,321,294</u>	<u>\$ 1,305,228</u>

Note 7 - Long-term Debt

Long-term liability activity for the years ended June 30, 2006 and 2005 was as follows:

	Beginning Balance	Current Year Additions	Current Year Reductions	Ending Balance	Amounts Due Within One Year
2006					
Bonds - Series 2004	<u>\$ 6,626,667</u>	<u>\$ -</u>	<u>\$ (473,333)</u>	<u>\$ 6,153,334</u>	<u>\$ 473,333</u>
2005					
Bonds -Series 2004	<u>\$ 7,100,000</u>	<u>\$ -</u>	<u>\$ (473,333)</u>	<u>\$ 6,626,667</u>	<u>\$ 473,333</u>

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 7 - Long-term Debt (Continued)

The bonds payable are summarized as follows:

- Series 2004 consisted of South Haven Community Hospital Authority revenue and revenue refunding bonds issued to pay off previous long-term debt and to finance a renovation project. The bonds bear interest ranging from 2.7 percent to 5.4 percent. Principal payment of \$473,333 are due each November 1, beginning in 2004 through 2018. Interest payments are due semiannually on November 1 and May 1 of the same period. The bonds are collateralized by net revenue of the Hospital.

The following is a schedule by years of bond principal and interest as of June 30, 2006:

Year Ending December 31	Long-term Debt	
	Principal	Interest
2007	\$ 473,333	\$ 263,410
2008	473,333	249,565
2009	473,333	233,827
2010	473,333	216,546
2011	473,333	197,967
2012-2016	2,366,665	668,099
2017-2019	1,420,004	113,836
Total payments	<u>\$ 6,153,334</u>	<u>\$ 1,943,250</u>

Note 8 - Tax-deferred Annuity Retirement Plan

The Hospital provides pension benefits to all of its full-time employees through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan, plus investment earnings. Under the plan, the Hospital contributes amounts matching employees' contributions up to 5 percent of base pay for participating employees. In accordance with these requirements, the Hospital contributed \$322,253 during the current year and employees contributed \$565,902. For the year ended June 30, 2005, the Hospital contributed \$297,478 and employees contributed \$522,001.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for malpractice and general liability claims, and participates in the Michigan Hospital Association risk pool for claims relating to workers' compensation. The Hospital is self-insured for employee medical claims. Changes in the estimated liability (included in accrued liabilities) for the past two fiscal years were as follows:

	2006	2005
Estimated liability - Beginning of year	\$ 89,000	\$ 225,000
Estimated claims incurred, including changes in estimates	1,836,974	1,020,367
Claim payments	(1,776,974)	(1,156,367)
Estimated liability - End of year	<u>\$ 149,000</u>	<u>\$ 89,000</u>

Malpractice - The Hospital is insured against potential professional liability claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital must pay a deductible towards the cost of litigating or settling any asserted claims. In addition, the Hospital bears the risk of the ultimate costs of any individual claim exceeding the policy limits for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital has been named a defendant in several malpractice suits. All cases involving the Hospital are in the very early stages and it would be premature to evaluate the likely outcome, amount of settlement, if any, or whether settlements could exceed the insurance coverage. Management intends to vigorously defend these suits and does not expect any unfavorable impact.

The accrual for estimated malpractice claims was \$250,000 and \$150,000 at June 30, 2006 and 2005, respectively. Management believes, after considering legal counsel's evaluations of all actions and claims, that insurance coverage and accruals for estimated losses are adequate to cover expected settlements.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2006 and 2005

Note 10 - Nonoperating Income and Expense

The details of nonoperating income are shown below:

	2006	2005
Income on investments limited as to use	\$ 419,935	\$ 451,264
Net decrease in fair value of investments	(306,850)	(81,998)
Unrestricted investment income	52,554	20,090
Medical office building - Net loss	(75,430)	(59,001)
Disposal of equipment - Net gain (loss)	10,754	(20,598)
Donations	32,030	21,711
Tax levy	349,860	365,107
Interest expense	(278,087)	(286,402)
Other	(19,968)	31,557
Total nonoperating income - Net	<u>\$ 184,798</u>	<u>\$ 441,730</u>